IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 828

DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor,

Petitioner,

against

HAYSTONE SECURITIES CORPORATION, a corporation of the State of New York,

Respondent,

and

H. M. BYLLESBY AND COMPANY; BYLLESBY CORPORATION; WALTER T. ROSEN, HARRY B. LAKE, PAUL MARSHALL ROSENTHAL, HENRY MARCH, JOHN ROSENTHAL and EDWARD E. THALMANN, as Co-Partners doing business under the firm name and style of Ladenburg, Thalmann & Co.; EDWARD E. THALMANN, as surviving executor of the last will and testament of ERNEST THALMANN, deceased; BENJAMIN S. GUINNESS; LOUIS M. LEVINE, ALMA METZ and HENRY L. MOSES, as executors of the last will and testament of Rudolph Metz, deceased; SIDNEY BACHARACH, VIRGINIA M. ROSENTHAL, PAUL M. ROSENTHAL, JOHN ROSENTHAL and FREDERICK M. HEIMERDINGER, as executors of the last will and testament of Moritz Rosenthal, deceased; FIRST SECURITY COMPANY, a corporation of the State of New York; AMEREX HOLDING CORPORATION, a corporation of the State of New York; UNION TRUST COMPANY OF PITTSBURGH, a corporation of the Commonwealth of Pennsylvania; STANDARD POWER AND LIGHT CORPORATION, a corporation of the State of Delaware; ARTHUR C. ALLYN; BERNARD F. BRAHENEY; JOSEPH H. BRIGGS; ORJA G. CORNS; ALBERT S. CUMMINS; HENRY C. CUMMINS; VICTOR EMANUEL; DENNIS T. FLYNN; ROBERT J. GRAF; E. CARLETON GRANBERY; JOHN L. GRAY; ROBERT G. HUNT; HENRY H. JONES; SAMUEL KAHN; WILLIAM C. LANGLEY; CHESTER C. LEVIS; DUNCAN R. LINSLEY; HERBERT LIST; BERNARD W. LYNCH; MATTHEW A. MORRISON; THOMAS A. O'HARA; JAMES F. OWENS; ROBERT F. PACK; WILLIAM G. POHL; JOHN P. PULLIAM; WILLIAM F. RABER; ROYAL E. T. RIGGS; ANDREW W. ROBERTSON; LOUIS H. SEAGRAVE; FREDERICK W. STEHR; T. BERT WILSON; ANNA G. BREWER, as Executrix of the last will and testament of Chauncey M. Brewer, deceased; and MARTIN J. O'BRIEN, as executor of the last will and testament of John J. O'Brien, deceased,

Defendants.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

FRANCIS J. QUILLINAN,
Counsel for Petitioner.

SIDNEY R. NUSSENFELD,
MAX J. RUBIN,
WILLIAM H. FOULK,
FREDERICK BAUM,
Of Counsel.

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Defendants.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor, by his attorneys, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of New York entered in the above case on October 13, 1944, dismissing the complaint as against the respondent Haystone Securities Corporation and affirming the judgment of the Appellate Division of the Supreme Court of New York for the First Department, which reversed the order of the Supreme Court, New York County.

Opinions Below.

The opinion of the Supreme Court, New York County (R. 67) is not reported. The opinion of the Appellate Division of the Supreme Court for the First Department (R. 73) is reported in 265 App. Div. 643 and in 40 N. Y. S. 2d 299. The opinion of the New York Court of Appeals (R. 82) is reported in 293 N. Y. 404.

Jurisdictional Statement.

The remittitur of the Court of Appeals of New York was entered on October 13, 1944 (R. 87). The jurisdiction of this Court is invoked under Section 237(b) of the Judicial Code, as amended, of the Act of February 13, 1925, on the ground that the decision below denied a title and right claimed by the petitioner under the Bankruptcy

Act, c. 541, 30 Stat. 557, as amended by c. 412, sec. 8, 36 Stat. 840, c. 575, sec. 1, 52 Stat. 879, 881 (11 U. S. C. sec. 110c).

The Federal question was passed upon by the Justice at Special Term in his opinion as follows (R. 67):

> "As such trustee plaintiff is vested with such title as a trustee appointed under section 44 of the Bankruptcy Act acquires (see sec. 186 of the Bankruptcy Act) and possesses the same rights and powers as a section 44 trustee (sec. 187, Bankruptcy Act). A trustee appointed under section 44 (*supra*) 'shall be deemed vested as of the date of bankruptcy with all the rights, remedies and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists' (sec. 70, subdiv. C, Bankruptcy Act). It follows that plaintiff possesses all the rights, remedies and powers of a judgment creditor of Standard Gas & Electric Company holding an execution duly returned unsatisfied.
>
> "The sixteenth cause of action may be maintained by a creditor of the corporation, pursuant to sections 60 and 61 of the General Corporation Law, only after the entry of judgment and the return of execution unsatisfied. The statute of limitations, therefore, did not commence to run against such cause of action in favor of a creditor until the entry of judgment and the return of execution unsatisfied (*Buttles* v. *Smith*, 281 N. Y. 226). It did not start to run as against the plaintiff until he was appointed trustee of the corporation, and thereby acquired the rights of a judgment creditor holding execution returned unsatisfied. Since plaintiff was not appointed trustee until November 26, 1937, less than three years prior to the commencement of this action, the statute of limitations is no bar to the successful maintenance of the action."

The Appellate Division, in reversing the order of the Special Term, passed upon the Federal question as follows (R. 77):

> "Special Term reasoned that as Section 70e of the Bankruptcy Act (U. S. C. A., Title 11, Sec. 110e) provides that a trustee in bankruptcy is vested with 'all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied', plaintiff acquired the rights of a judgment creditor on his appointment as trustee, and had a cause of action which did not accrue until his appointment. We deem this ruling erroneous. No doubt a trustee in bankruptcy may sue to enforce the rights of a creditor as well as to sue to collect those claims owned by the bankrupt estate. The trustee would be empowered to set aside fraudulent transfers of the bankrupt's property, where the wrong complained of was actionable at common law, or under the Bankruptcy Act §67 (U. S. C. A., Title 11, §107). But the present action was not one to set aside a fraudulent transfer of the bankrupt's property."

The question was raised on appeal to the Court of Appeals by specification in the notice of appeal to that Court that appeal was taken from each and every part of the judgment of the Appellate Division (R. 69). Under the practice of the State of New York, this was the prescribed method for bringing up for review the entire judgment of the Appellate Division (N. Y. Civ. Pract. Act, Sec. 562). The question was briefed in the briefs of both petitioner and respondent submitted to the Appellate Division and to the Court of Appeals. The grounds upon which it is contended that the question involved is substantial are set forth under the Reasons for Granting the Writ, *infra* pp. 8-16.

Statute Involved.

Section 47 (a) (2) (now Section 70e) of the Bankruptcy Act, approved July 1, 1898, c. 541, 30 Stat. 557; as amended by Act of June 25, 1910, c. 412, sec. 8, 36 Stat. 840; Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 879, 881 (11 U. S. C. Sec. 110e) provides:

> "* * * The trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists; and, as to all other property, the trustee shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists."

Questions Presented.

1. Where a state statute entitles both a corporation and its judgment creditors holding execution returned unsatisfied to sue for wrongs done to the corporation, whether an action thereunder by a trustee in bankruptcy of the corporation may be declared barred by the statute of limitations even though such action would not have been barred if maintained by the judgment creditor.

2. Whether a trustee in bankruptcy of a corporation suing under a state statute which entitles both the corporation and its judgment creditors to maintain an action for

wrongs done to the corporation, is limited to the status and infirmities which would inhere if such suit were maintained by the corporation, or whether he is entitled under Section 70c of the Bankruptcy Act to be accorded the superior position which a judgment creditor so suing would have enjoyed.

Statement of the Matter Involved.

In September 1935, Standard Gas and Electric Company (hereinafter sometimes referred to as the Debtor) filed a petition for reorganization under Section 77B of the Bankruptcy Act in the United States District Court for the District of Delaware (R. 36). By order dated November 26, 1937, the District Court appointed petitioner as Special Trustee of the Debtor, with authority to bring suit upon certain causes of action described therein (R. 43). Jurisdiction was and still is reserved by the District Court over said causes of action (R. 45, 54, 57).

The petitioner as such trustee instituted suit in December 1939 in the Supreme Court, New York County. This sought an accounting under New York General Corporation Law Sections 60 and 61 from directors of the Debtor and co-conspirators for property of the corporation alleged to have been unlawfully and fraudulently appropriated by them, and for recovery of losses sustained by the corporation (R. 10). The provisions of the Gen. Corp. Law Sections 60, 61, under which the action was brought, are set forth in the appendix hereto.

Defendants first challenged petitioner's capacity to sue, by motion to dismiss the complaint. This motion was denied on appeal (*Hastings* v. *Byllesby & Co.*, 286 N. Y. 468). The opinion quoted with approval the statement of the United States Circuit Court of Appeals for the

Third Circuit which described the status of petitioner as follows (*In re Standard Gas & Electric Co.-Hastings* v. *H. M. Byllesby & Co.*, 119 F. (2d) 658, 661):

> "It seems clear, however, from an examination of the order of appointment that the plaintiff was appointed trustee under section 77B with title to the choses in action sued on and with the powers which the Bankruptcy Act confers upon such a trustee to bring suit for the recovery thereof."

The respondent Haystone Securities Corporation then moved to dismiss the 16th cause of action in the complaint on the ground of the statute of limitations (R. 4). The Special Term denied the motion (R. 3). It held that under Section 70c of the Bankruptcy Act (11 U. S. C. Sec. 110c), the petitioner became vested upon his appointment with the rights of a judgment creditor holding execution returned unsatisfied; that under Gen. Corp. Law Sections 60, 61, a creditor of the corporation could sue only after obtaining judgment with execution returned unsatisfied; and that therefore the statute did not start to run against the petitioner until he was appointed trustee (R. 67).

The Appellate Division reversed the foregoing order and directed judgment dismissing the complaint as against respondent Haystone Securities Corporation (R. 70). The Court of Appeals affirmed the decision of the Appellate Division (R. 87).

The opinion of the Court of Appeals (R. 82) did not question the New York decisions holding that in an action under Gen. Corp. Law Sections 60, 61, a creditor may not sue until entry of judgment with execution returned unsatisfied, and that therefore the statute does not commence run-

ning against such action until the creditor obtains judgment with execution returned unsatisfied. Nor did it question that petitioner occupied the status of a trustee in bankruptcy, with the rights of a judgment creditor pursuant to Section 70c of the Bankruptcy Act. However, the Court of Appeals purported to distinguish the instant case on the ground that it was a suit under subdivisions 1 and 2 of Gen. Corp. Law Section 60, based on acts which constituted a wrong to the corporation, that therefore the trustee could sue only in the right of the corporation, and concluded that the statute commenced running from the date that the corporation could have sued, and not from the appointment of the petitioner as trustee.

Petitioner contends that this constituted a denial to a trustee of the rights vested in him under Section 70c of the Bankruptcy Act, and a misinterpretation of a fundamental provision of the Bankruptcy Act, as more fully set forth under the Reasons for Granting the Writ, *infra* pages 8-16.

Reasons for Granting the Writ.

1. The Court of Appeals of New York has decided an important Federal question not in accord with the applicable decisions of the Federal and state courts. The holding of the Court of Appeals in the instant case is that where a bankruptcy trustee sues on the basis of acts which constituted a wrong to the corporation, then he is subject to the statute of limitations which would have governed if the bankrupt corporation had sued, even though a different and more beneficial statute would have applied if a judgment creditor with execution returned unsatisfied had instituted the action, according to the prior decisions which

are reaffirmed. This determination denies to petitioner a right clearly vested in him under Section 70e of the Bankruptcy Act.

Ever since the 1910 Amendment to the Bankruptcy Act added the "Strong Arm Clause" (Act of June 25, 1910, c. 412, sec. 8, 36 Stat. 840), it has been uniformly held that a trustee in bankruptcy no longer is vested merely with the title of the bankrupt, but he is granted the additional rights which would be accorded under state law to a creditor holding a lien or obtaining judgment with execution returned unsatisfied, regardless of whether such creditor actually exists (*Fairbanks Steam Shovel Co.* v. *Wills*, 240 U. S. 642, 649; *Southern Dairies* v. *Banks*, 92 F. (2d) 282, 285 (C. C. A. 4); *In re Toms*, 101 F. (2d) 617, 619 (C. C. A. 6); *In re Seward Dredging Co.*, 242 Fed. 225, 227 (C. C. A. 2), cert. den. 245 U. S. 651; *Hayes* v. *Gibson*, 279 Fed. 812, 814 (C. C. A. 3); *Whitfield* v. *Kern*, 122 N. J. Eq. 332, 192 Atl. 48; 4 Remington on Bankruptcy (4th ed.), Secs. 1507, 1547).

The trustee is entitled to choose whichever of these rights, whether derived from the bankrupt or the creditor status, may be the more favorable. When suing on the basis of the rights of creditors, he is not limited by the infirmities that would attach to a suit by the bankrupt.

As stated in *In re Seward Dredging Co.* (*supra*):

> "* * * Since 1910, a trustee has two rights as to property in his custody; i. e., that of the bankrupt and that of such a creditor as is described. They are different rights, sometimes antagonistic; the trustee can take his choice."

In *In re Dalton Electric Co.*, 7 F. Supp. 465, 468 (D. C. Miss.), the Court stated:

> "Returning to the right of the corporation to sue an officer who has made an illegal loan of corporate funds to a stockholder of the corporation, the claim is a property right or chose in action vesting in the corporation by reason of the violation of a statutory duty. This property right passes to the trustee in bankruptcy under section 70 of the act (11 U. S. C. A. §110). For this illegal loan a direct right, remedy, or power to sue is given specified creditors by said section 4151 of the Mississippi Code of 1930. It is a right 'as to property of the bankrupt' given creditors of the bankrupt by a state statute. It also passes to the trustee in bankruptcy under section 47a (2a) of the Bankruptcy Act, because, under said section, the trustee does not merely stand in the shoes of the bankrupt, but occupies the status of its most favored general creditor who has obtained a judgment and holds an execution duly returned unsatisfied.
>
> Since the amendment of 1910, decisions holding that a trustee has no other right than belonged to the bankrupt are no longer controlling."

The Court of Appeals in the instant case has held that this accepted construction of the Bankruptcy Act does not apply where the rights of the bankrupt corporation and its creditors would differ under the state statute of limitations. It has held that if the statute of limitations would have barred an action by the bankrupt at the date of bankruptcy, then the trustee must also be held barred, even though under the state law a creditor obtaining judgment with execution returned unsatisfied immediately prior to the date of bankruptcy would not have been barred from maintaining the same suit.

The rule in New York is that the period of limitations "must be computed from the time of the accruing of the right to relief by action" (N. Y. Civ. Pract. Act, Sec. 11). This is in accordance with the general rule (*Fisher* v. *Whiton*, 317 U. S. 217, 220).

Under N. Y. Gen. Corp. Law, Sections 60, 61 (quoted *infra*, appendix), the right is given to both a corporation and its creditors to sue for wrongs done to the corporation. The New York Courts have uniformly held that under this statute a creditor acquires no "right to relief by action" until he obtains judgment with execution returned unsatisfied. This rule has been applied to all creditors' actions under Gen. Corp. Law Sec. 60, regardless of what subdivision thereunder they may be brought (*Levy* v. *Paramount Publix Corp.*, 265 N. Y. 629; *Buttles* v. *Smith*, 281 N. Y. 226; *Steele* v. *Isman*, 164 App. Div. 146; *Cole* v. *Knickerbocker Life Ins. Co.*, 23 Hun 255; *Paulsen* v. *Van Steenbergh*, 65 How. Pr. 342).

It follows from the foregoing that the statute of limitations does not start running against an action by a creditor under Gen. Corp. Law Section 60 until he obtains judgment with execution returned unsatisfied, and so it has been consistently held in New York. Thus, in *Buttles* v. *Smith*, *supra*, the Court stated (281 N. Y. at p. 236):

> "Where an action is brought under section 60 of the General Corporation Law or section 15 of the Stock Corporation Law, no cause of action accrues to a creditor, with certain exceptions* which need not be considered here since none of them have been

* The exceptions referred to are cases in which it would obviously be futile to obtain judgment and levy execution as where the corporation has been dissolved and a receiver appointed (*Steele* v. *Isman*, 164 App. Div. 146, 149; *Levy* v. *Paramount Publix Corp.*, 149 Misc. 129, 132, aff'd. 241 App. Div. 781, aff'd. 265 N. Y. 629).

> alluded to by respondents, until judgment has been obtained and execution returned unsatisfied (*Levy* v. *Paramount Publix Corp.*, 265 N. Y. 629), and any statute of limitations did not commence to run until the cause of action accrued to the creditor (*Shepard Co.* v. *Taylor Publishing Co.*, 234 N. Y. 465)."

In the similar situation of a suit by a judgment creditor under New York Stock Corporation Law Section 15 to recover a preferential payment, the Court of Appeals in *Shepard Co.* v. *Taylor Publishing Co.*, 234 N. Y. 465, 468, stated:

> "* * * The right of a creditor to bring an action to set aside a fraudulent transfer of property made by his debtor ordinarily does not accrue until the recovery of a judgment against the debtor and the return of an execution thereon unsatisfied. Until that time, therefore, the Statute of Limitations does not begin to run against such a cause of action. (*Weaver* v. *Haviland*, 142 N. Y. 534; *Holland* v. *Grote*, 125 App. Div. 413.)"

Likewise, in a suit under New York Stock Corporation Law Section 58 which creates a liability of directors to a corporation and its judgment creditors for payment of dividends out of capital, the Courts have held that the statute of limitations does not start running against a creditor until he obtains judgment (*Rosenkranz* v. *Doran*, 264 App. Div. 335).

Since under Section 70c of the Bankruptcy Act a trustee acquires the same rights as would be accorded to a creditor who obtained judgment with execution returned unsatisfied, it follows that a suit by the trustee under Gen. Corp. Law Section 60 would not accrue until his appointment. Hence the instant action is not barred, even though it might have

been barred if the corporation had sued. So the Special Term Court reasoned and held (R. 67).

The contrary conclusion of the Court of Appeals purports to rest upon non-Federal grounds, but there is no reality or substance to the pretended distinction between the instant case and the foregoing New York authorities. This Court has held on numerous occasions that it is within its province "to inquire not only whether the right was denied in express terms, but also whether it was denied in substance and effect, as by putting forward non-Federal grounds of decision that were without any fair or substantial support" (*Ward* v. *Love County*, 253 U. S. 17, 22; *Postal Tel.-Cable Co.* v. *Newport*, 247 U. S. 464, 473-5; *Ancient Egyptian Arabic Order N. M. S.* v. *Michaux*, 279 U. S. 737, 744).

The opinion of the Court of Appeals purports to distinguish the instant case from the prior New York authorities on the ground that here the action was brought under Gen. Corp. Law Section 60, subdivisions 1 and 2, involving a derivative action for wrongs done to the bankrupt. But the Court does not purport to question or overrule all of the prior New York authorities holding that a creditor has no standing to sue under *any* subdivision of Gen. Corp. Law Section 60 until he has obtained judgment with execution returned unsatisfied. *Levy* v. *Paramount Publix Corp.* (265 N. Y. 629), which reaffirmed this doctrine, was an action brought under subdivisions 1 and 2, the same as in the instant case, and was approved in *Buttles* v. *Smith* (281 N. Y. 226), which in turn was approved in the instant case. It is still the New York law that the statute of limitations starts running only from "the accruing of the right to relief by action"; and that a creditor has no right to relief by action under *any* subdivision of Gen. Corp. Law Section

60 until obtaining judgment with execution returned unsatisfied.

Nor is there any distinction in the fact that the acts alleged in the instant case also constituted a cause of action for which the corporation could have sued. The prior cases held that the statute did not commence running until after the creditor obtained judgment, without regard to whether the corporation could or could not have sued on the same facts. Thus, in the *Shepard* case, *supra*, the Court stated: "The corporation or its stockholders might have brought this action" (234 N. Y. at p. 468). And the payment in the *Buttles* case, *supra*, of corporate funds in discharge of personal obligations of the president constituted a wrong to the corporation. Likewise, the payment of dividends out of capital in *Rosenkranz* v. *Doran, supra,* created a cause of action enforceable by the corporation, as well as by its judgment creditors. Nevertheless, in all these decisions, the Courts held that the action accrued when the creditor obtained judgment, without giving any consideration or weight to the question whether a cause of action based on the acts alleged would have been barred if sued on by the corporation.

If the opinion below were actually creating a distinction on the basis of whether the acts sued on constituted a wrong to the corporation, then it would have to overrule all of the foregoing prior New York decisions. It did not do so, but expressly reaffirmed the *Buttles* decision. Hence, the fact that the acts alleged constituted a wrong to the corporation cannot be the distinguishing element in the instant case, since the same fact played no part in the prior decisions which are reaffirmed. Indeed, it is difficult to see how any such distinction could be made without abrogating the rule established in the cases set forth above, since in those cases

the right given to the creditor is to vindicate wrongs done to the corporation.

2. The question involved in the instant case affects the rights of trustees in bankruptcy in the numerous situations in which state statutes confer rights upon both a corporation and its creditors to sue for improper acts done with respect to the corporation. This would include statutes permitting suit to be instituted by creditors for payments of dividends made out of capital (*e.g. Rosenkranz* v. *Doran*, 264 App. Div. 335); for unpaid stock subscriptions (*e.g. Kiskadden* v. *Steinle*, 203 Fed. 375 (C. C. A. 6)); for improper loans to officers (*e.g. In re Dalton Electric Co.*, 7 F. Supp. 465); and for waste of corporate assets (*e.g. Stephan* v. *Merchants Collateral Corp.*, 256 N. Y. 418). In all of these cases, the doctrine of the Court below would limit the suit by a trustee in bankruptcy to the status which the bankrupt corporation would have occupied, even though a judgment creditor so suing would have enjoyed superior rights with reference to the statute of limitations or in any other respect.

Suits by trustees appointed under the Bankruptcy Act have increased in number and importance as a result of the provisions of Section 77B and its successor Chapter X, which place a duty upon the reorganization court to investigate all charges of mismanagement and provide for their prosecution by a trustee when liability may exist. As stated in *In re Philadelphia & Reading Coal & Iron Co.*, 105 F. (2d) 354, 356 (C. C. A. 3):

> "We think it clear that it is not the purpose of Sec. 77B, or of Chap. X which succeeded it, to furnish immunity to wrongdoing by corporate officers if the requisite majorities of creditors and stockholders approve a plan of reorganization which

> leaves those officers in possession of the debtor without an investigation of their conduct. On the contrary the duty of the court to direct the investigation of all substantial allegations of mismanagement and fraud is plain. It is equally plain that it would not be fair to the individual creditors of a debtor for the court, before the preliminary report required of the trustee or examiner by Sec. 167 (5) of Chap. X, 11 U. S. C. A. §567 (5), had been made, to permit the submission to them of a plan of reorganization which did not adequately preserve and provide for the prosecution of causes of action which might exist if such allegations of mismanagement and fraud were true."

It is essential to the effectuation of this policy that the Courts recognize the full strength of the weapon with which such trustees are armed under the clear mandate of Section 70c of the Bankruptcy Act, that their rights are derived not merely from the debtor, but also from the status of creditors of the debtor.

Conclusion.

The decision of the Court below is in conflict with the applicable decisions of the Federal and State Courts. The question involved is one of substantial importance which calls for an authoritative ruling by this Court. Therefore it is respectfully submitted that this petition for a writ of certiorari should be granted.

WHEREFORE, petitioner prays that this Court may issue its writ of certiorari to review the decision of the Court below.

Dated: January 8, 1945.

DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor

By FRANCIS J. QUILLINAN,
Counsel for Petitioner.

SIDNEY R. NUSSENFELD,
MAX J. RUBIN,
WILLIAM H. FOULK,
FREDERICK BAUM,
Of Counsel.

Appendix.

New York General Corporation Law Sections 60 and 61 provide as follows:

> "§ 60. *Action against officers of corporation for misconduct*
>
> "An action may be brought against one or more of the directors or officers of a corporation to procure judgment for the following relief or any part thereof:
>
> "1. To compel the defendants to account for their official conduct, including any neglect of or failure to perform their duties, in the management and disposition of the funds and property, committed to their charge.
>
> "2. To compel them to pay to the corporation, or to its creditors, any money and the value of any property, which they have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform or other violation of their duties.
>
> "3. To suspend a defendant from exercising his office, for an abuse of his trust.
>
> "4. To remove a defendant from office and to direct the filling of the vacancy in accordance with the charter and by-laws of the corporation, or, if they contain no provision therefor, in such manner as the court shall direct.
>
> "5. To set aside a transfer of property, made by one or more directors or officers of a corporation, contrary to a provision of law, where the transferee knew the purpose of the transfer.
>
> "6. To enjoin such a transfer where there is good reason to apprehend that it will be made."

"§ 61. *Who may bring such action*

"An action may be brought for the relief prescribed in the last section, by the attorney-general in behalf of the people of the state, or except for the relief specified in the third and fourth subdivisions, by the corporation or a creditor, receiver or trustee in bankruptcy thereof, or by a director or officer of the corporation.

"Upon the application of either party the court shall make an order directing the trial by jury of the issue of negligence, and for that purpose the questions to be tried must be prepared and settled as prescribed in section four hundred and twenty-nine of the civil practice act."

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DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor, *Petitioner,*

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HAYSTONE SECURITIES CORPORATION, a corporation of the State of New York, *Respondent,*

and

H. M. BYLLESBY AND COMPANY; BYLLESBY CORPORATION; WALTER T. ROSEN, HARRY B. LAKE, PAUL MARSHALL ROSENTHAL, HENRY MARCH, JOHN ROSENTHAL and EDWARD E. THALMANN, as Co-Partners doing business under the firm name and style of Ladenburg, Thalmann & Co.; EDWARD E. THALMANN, as surviving executor of the last will and testament of ERNEST THALMANN, deceased; BENJAMIN S. GUINNESS; LOUIS M. LEVINE, ALMA METZ and HENRY L. MOSES, as executors of the last will and testament of Rudolph Metz, deceased; SIDNEY BACHARACH, VIRGINIA M. ROSENTHAL, PAUL M. ROSENTHAL, JOHN ROSENTHAL and FREDERICK M. HEIMERDINGER, as executors of the last will and testament of Moritz Rosenthal, deceased; FIRST SECURITY COMPANY, a corporation of the State of New York; AMEREX HOLDING CORPORATION, a corporation of the State of New York; UNION TRUST COMPANY OF PITTSBURGH, a corporation of the Commonwealth of Pennsylvania; STANDARD POWER AND LIGHT CORPORATION, a corporation of the State of Delaware; ARTHUR C. ALLYN; BERNARD F. BRAHENEY; JOSEPH H. BRIGGS; ORJA G. CORNS; ALBERT S. CUMMINS; HENRY C. CUMMINS; VICTOR EMANUEL; DENNIS T. FLYNN; ROBERT J. GRAF; E. CARLETON GRANBERY; JOHN L. GRAY; ROBERT G. HUNT; HENRY H. JONES; SAMUEL KAHN; WILLIAM C. LANGLEY; CHESTER C. LEVIS; DUNCAN R. LINSLEY; HERBERT LIST; BERNARD W. LYNCH; MATTHEW A. MORRISON; THOMAS A. O'HARA; JAMES F. OWENS; ROBERT F. PACK; WILLIAM G. POHL; JOHN P. PULLIAM; WILLIAM F. RABER; ROYAL E. T. RIGGS; ANDREW W. ROBERTSON; LOUIS H. SEAGRAVE; FREDERICK W. STEHR; T. BERT WILSON; ANNA G. BREWER, as Executrix of the last will and testament of Chauncey M. Brewer, deceased; and MARTIN J. O'BRIEN, as executor of the last will and testament of John J. O'Brien, deceased, *Defendants.*

BRIEF FOR HAYSTONE SECURITIES CORPORATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

HORACE G. HITCHCOCK,
Counsel for Respondent.

DWIGHT R. COLLIN,
Of Counsel.

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OTHER AUTHORITIES CITED

IN THE

Supreme Court of the United States

October Term, 1944

No. 828

DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor,

Petitioner,

against

HAYSTONE SECURITIES CORPORATION, a corporation of the State of New York,

Respondent,

and

H. M. BYLLESBY AND COMPANY; BYLLESBY CORPORATION; WALTER T. ROSEN, HARRY B. LAKE, PAUL MARSHALL ROSENTHAL, HENRY MARCH, JOHN ROSENTHAL and EDWARD E. THALMANN, as Co-Partners doing business under the firm name and style of Ladenburg, Thalmann & Co.; EDWARD E. THALMANN, as surviving executor of the last will and testament of ERNEST THALMANN, deceased; BENJAMIN S. GUINNESS; LOUIS M. LEVINE, ALMA METZ and HENRY L. MOSES, as executors of the last will and testament of Rudolph Metz, deceased; SIDNEY BACHARACH, VIRGINIA M. ROSENTHAL, PAUL M. ROSENTHAL, JOHN ROSENTHAL and FREDERICK M. HEIMERDINGER, as executors of the last will and testament of Moritz Rosenthal, deceased; FIRST SECURITY COMPANY, a corporation of the State of New York; AMEREX HOLDING CORPORATION, a corporation of the State of New York; UNION TRUST COMPANY OF PITTSBURGH, a corporation of the Commonwealth of Pennsylvania; STANDARD POWER AND LIGHT CORPORATION, a corporation of the State of Delaware; ARTHUR C. ALLYN; BERNARD F. BRAHENEY; JOSEPH H. BRIGGS; ORJA G. CORNS; ALBERT S. CUMMINS; HENRY C. CUMMINS; VICTOR EMANUEL; DENNIS T. FLYNN; ROBERT J. GRAF; E. CARLETON GRANBERY; JOHN L. GRAY; ROBERT G. HUNT; HENRY H. JONES; SAMUEL KAHN; WILLIAM C. LANGLEY; CHESTER C. LEVIS; DUNCAN R. LINSLEY; HERBERT LIST; BERNARD W. LYNCH; MATTHEW A. MORRISON; THOMAS A. O'HARA; JAMES F.

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Defendants.

BRIEF FOR HAYSTONE SECURITIES CORPORATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

Opinions Below

The opinion of the Supreme Court, New York County (R. 67) is not reported. The opinion of the Appellate Division of the Supreme Court for the First Department (R. 73) is reported in 265 App. Div. 643 and in 40 N. Y. S. 2d 299. The opinion of the New York Court of Appeals (R. 82) is reported in 293 N. Y. 404.

Jurisdiction

Respondent Haystone Securities Corporation denies that the jurisdiction of this Court can be properly invoked under Section 237(b) of the Judicial Code. No Federal question was presented for decision to the Court of Appeals of the State of New York nor was any right arising under a Federal statute denied to petitioner. Assuming *arguendo*, without conceding, that petitioner succeeded in raising a Federal question, the decision of a Federal question was not necessary to the determination of the case and the case

was properly decided on other grounds without decision of any Federal question.

The questions presented for decision to the Court of Appeals were:

(1) Whether the action was a derivative action on a cause of action belonging to the corporate debtor for a wrong allegedly done to the debtor which passed to petitioner as special trustee,

(2) Whether the action was brought under Section 60 of the General Corporation Law of the State of New York (printed in appendix to Petition);

(3) Whether the action, brought by petitioner as a bankruptcy trustee, with the rights, remedies and powers of a judgment creditor holding execution duly returned unsatisfied, if brought under Section 60 of the General Corporation Law was barred by the State Statute of Limitations (Section 48, New York Civil Practice Act).

The Court of Appeals decided that the action was for a wrong to the debtor, and accrued to the debtor when the wrong occurred; hence, whether or not the action was brought under Section 60, and in whatever capacity the plaintiff sued, it was a derivative action for wrong to the corporate debtor and barred by the State Statute of Limitations.

There was no occasion to decide any question involving interpretation of Section 70e of the Bankruptcy Act. No exception was ever taken to the proposition that a bankruptcy trustee has the rights, remedies and powers set forth therein. The Court of Appeals expressly disclaimed any intention to decide any question as to the power or

capacity of a trustee in bankruptcy to bring this action, stating (R. 86):

> "There would, indeed, be serious doubt whether a trustee in bankruptcy would have capacity to sue upon a cause of action which did not belong to the debtor other than a cause of action to set aside illegal transfers of property and unlawful preferences. (See *In re Jacoby*, 138 F. 2d 42; *Sanford* v. *Boland*, 287 N. Y. 431; *Courtney* v. *Georger*, 228 F. 859, certiorari denied 241 U. S. 660; *Morris* v. *Sampsel*, 224 Wisc. 560; 4 Collier on Bankruptcy [14th ed.], pp. 1182-1183.) We need not attempt to resolve that doubt in this case since we hold that under the law of the State the cause of action here asserted is based upon a wrong to the corporate debtor and accrued when the wrong to the debtor corporation was complete."

The effect of the decision of the Court of Appeals was that, assuming that a trustee in bankruptcy had the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied, as contended by petitioner; and, assuming the suit was brought by such a judgment creditor under the State statute (Section 60, General Corporation Law), as contended by the petitioner; it was nevertheless barred by the State Statute of Limitations.

Questions Presented

Respondent contends that petitioner's statement of questions presented does not find support in the record and does not correctly reflect the basis of decision of the Court of Appeals. It is not accurate to imply, as does the first question propounded by petitioner, that the Court of Appeals decided that an action by a trustee in bankruptcy of the cor-

poration may be declared barred by the Statute of Limitations even though such action would not have been barred if maintained by a judgment creditor. The Court of Appeals held explicitly that the action was equally barred whether maintained by a trustee in bankruptcy or a judgment creditor.

The second question incorrectly implies that it is established that a judgment creditor enjoys a superior position under State law when maintaining an action for wrongs done to a corporation. The decision of the Court of Appeals of the State of New York was directly to the contrary of this proposition. There was no discrimination against petitioner as trustee nor any denial of status as afforded by Section 70e of the Bankruptcy Act. The capacity of a judgment creditor to assert causes of action in the State courts, the nature and scope of the remedies of the judgment creditor, and the limitations upon actions by a judgment creditor all are necessarily questions of State law for final determination by the State court, and cannot be Federal questions.

Statement

Petitioner's "Statement of the Matter Involved" is deemed incomplete for the purposes of respondent's argument.

The nature of the action, as being of a derivative character for wrong allegedly done to the debtor corporation, is manifest from the complaint. It was so construed by both the New York appellate courts. Plaintiff's appointment limited him to the sole function of prosecuting such an action. The United States District Court for the District of Delaware in its order of appointment named petitioner

a "special trustee of and limited to" certain specified claims or causes of action of the debtor Standard Gas and Electric Company described therein "which existed in favor of the debtor prior to September 27, 1935".

Prior to the commencement of this action petitioner had commenced an action against respondent and others upon a complaint nearly identical with the complaint herein in the United States District Court for the District of Delaware. In the prior action he attempted to sustain the jurisdiction of the Delaware Court over respondent on the theory that the action related to "property of the debtor" and was, therefore, within the exclusive jurisdiction of the Bankruptcy Court pursuant to subdivision (a) of Section 77B of the Bankruptcy Act. This contention was rejected by the District Court (30 F. Supp. 21, p. 26). The decision of the District Court was affirmed by the Circuit Court of Appeals for the Third Circuit (119 F. (2d) 658), which held that in Section 77B Congress did not confer jurisdiction over claims by a debtor against third parties and that this was a species of property which might only be realized upon for the benefit of the debtor and its creditors by the successful prosecution of a plenary suit against the third parties involved. Obviously such a plenary suit would be subject to all of its infirmities.

When petitioner commenced this action, defendants successfully moved to dismiss the complaint on the ground that petitioner did not have capacity to sue in the courts of the State of New York. Upon appeal to the Court of Appeals of the State of New York, the judgment of dismissal was reversed (286 N. Y. 468) upon the ground that the "plaintiff is trustee under Section 77B of the Bank-

ruptcy Act (48 Stat. 912) of causes of action alleged to exist in favor of the debtor and referred to in the order of his appointment."

Petitioner had argued that he had capacity to sue as owner or assignee of causes of action of Standard Gas and Electric. In his brief to the Court of Appeals on that occasion, petitioner stated:

> "He is a special trustee in the sense that he does not have title to all of the company's property but only as to some, to wit, the causes of action."

After the decision of the Court of Appeals sustaining the capacity of petitioner to bring the action, Haystone Securities Corporation moved to dismiss the sixteenth cause of action, the only one against Haystone Securities Corporation, on the ground that as to it the complaint was barred by the Statute of Limitations. Under the previous decisions of the New York courts interpreting the Statute of Limitations as it applied to derivative corporate causes of action of this character there could be little doubt as to the favorable outcome of respondent's motion. *Potter* v. *Walker*, 276 N. Y. 15; *Dunlop's Sons, Inc.* v. *Spurr*, 285 N. Y. 333; *Frank* v. *Carlisle*, 286 N. Y. 586. An action on behalf of the corporation was barred in March, 1932 over five years prior to plaintiff's appointment as "special trustee" and more than seven years prior to the commencement of this action. In this predicament petitioner for the first time advanced the proposition that the action was one under Section 60 of the General Corporation Law, and that the petitioner as a bankruptcy trustee brought the action pursuant to Section 70e of the Bankruptcy Act as an independent action in the right of a judgment creditor holding a cause of action duly returned unsatisfied.

It was not apparent from the complaint that the action was in fact brought under Section 60 of the General Corporation Law of the State of New York as alleged in the petition to this Court.

The complaint contained no reference to Section 60. Haystone Securities Corporation was a defendant only to the sixteenth cause of action of the complaint. Haystone Securities Corporation was not a director or officer of Standard Gas and Electric nor was it a transferee of any property of the corporation. No relief against it as transferee was demanded in the complaint. The action was, as indicated by Chief Judge Lehman in his description of it in his opinion, an action to recover moneys and property of the debtor corporation which it is alleged in the complaint the defendants wasted, disposed of or took unlawfully or fraudulently, and to recover profits which it was alleged the defendants wrongfully appropriated. It was in effect an action against fiduciaries or those who, allegedly in connection with fiduciaries, had wrongfully benefited through breach of alleged fiudiciary duty.

Although this action had none of the *indicia* of a creditor's action, and appeared to be one to recover damages because of alleged waste or mismanagement of a corporation by alleged fiduciaries rather than an action to set aside illegal transfers in fraud of creditors, petitioner maintained in the State courts for the purpose of avoiding the Statute of Limitations that this action had become a new and distinct creditor's action as opposed to his previous contention when faced with the challenge to his capacity to sue, that the action was the action of the corporation of which he was the assignee.

The reason for belatedly ascribing the action to Section 60 of the General Corporation Law and claiming for it the status of a creditor's action was that in *Buttles* v. *Smith*, 281 N. Y. 226, the Court of Appeals had held that a judgment creditor's action, solely in the right of the creditor, to set aside a fraudulent transfer of assets of a corporation, was not barred against the creditor until return of execution unsatisfied on a judgment recovered by the creditor for his debt against the corporation. *Buttles* v. *Smith* was a case in which a receiver in sequestration proceedings on behalf of a judgment creditor, holding an execution returned unsatisfied, sued to recover from transferees payments made from an insolvent corporation's funds to pay the personal debts of its president. It was a genuine creditor's action to set aside transfers and not an action on behalf of the corporation. Any action on behalf of the insolvent corporation to recover the funds would have been barred but the Court of Appeals in that case held that as the receiver sued in the right of the creditor but not in the right of or derivatively to the corporation, the cause of action of the judgment creditor did not accrue until the return of execution unsatisfied.

The Court of Appeals, in *Buttles* v. *Smith*, had expressly distinguished a judgment creditor's action from a derivative action on behalf of a corporation. It had stated in describing the nature of the action in *Buttles* v. *Smith*:

> "It is not an action at law for damages sustained in consequence of wilful or negligent acts either of those entrusted with the funds in behalf of the corporation or of defendants. The distinction between the two types of action is clear. (*People* v. *Equitable Life Assur. Society*, 124 App. Div. 714; *Asphalt Con-*

struction Co. v. *Bouker,* 150 App. Div. 691, aff'd 210 N. Y. 643.)"

The Court of Appeals had thus expressly negatived the statement now made to this Court in the petition herein that under its prior decision a judgment creditor would be accorded a superior position when suing to maintain an action for wrongs done to the corporation, or that a different and more beneficial statute would have been applied if a judgment creditor with execution returned unsatisfied had instituted an action on behalf of the corporation for a wrong allegedly done to it.

Assuming that the instant action was an action pursuant to Section 60 of the General Corporation Law, it was obviously not an action to set aside an illegal transfer under subdivision (5) of Section 60. Assuming further that an action under Section 60 could be brought by a judgment creditor for wrongs done to the corporation under subdivisions (1) and (2), and, assuming that the right of such a judgment creditor to bring such an action must be postponed until he had obtained judgment and had an execution returned unsatisfied, a trustee or a special trustee in bankruptcy was under no such disability.

An action under Section 60 may be brought by the corporation or a creditor, receiver or trustee in bankruptcy thereof, or by a director or officer of the corporation. While there might have been an impediment therefore to an action by a judgment creditor until he had obtained judgment and had execution returned unsatisfied, there was no impediment to such an action by the corporation or by its assignee or by a trustee in bankruptcy suing in the right of the corporation. It was argued by Haystone Securities Cor-

poration to the Court of Appeals that this action could not be brought upon any independent creditor's right and that no independent creditor's cause of action would pass to a bankruptcy trustee.

It was suggested that the decisions of the State and Federal courts are unanimous that a cause of action accruing solely to the creditors of a corporation and not belonging to the corporation itself does not pass to the trustee in bankruptcy. (*Courtney* v. *Georger*, 228 F. 859, certiorari denied 241 U. S. 660; *Morris* v. *Sampsel*, 224 Wisc. 560, certiorari denied 305 U. S. 608; *In re Jacoby*, 138 F. (2d) 42; *Sanford* v. *Boland*, 287 N. Y. 431; Collier on Bankruptcy [14th ed.], §70; Remington on Bankruptcy [4th ed.], §1197.)

The Court of Appeals recognized the force of this argument but found it unnecessary to pass upon it in view of its holding "that under the law of the State the cause of action here asserted is based upon a wrong to the corporate debtor and accrued when the wrong to the debtor corporation was complete" (R. 86).

As to whether or not the action was brought under Section 60, the Court said (R. 86):

> "We assume *arguendo* that the action against Haystone Securities Corporation and its co-defendants is brought in behalf of creditors for the relief specified in subdivisions (1) and (2) of Section 60, though there may be little in the complaint to support that assumption."

The Court, therefore, gave the petitioner the full benefit of his contention in reaching its decision.

The Writ Should Be Denied

Petitioner's concession (p. 8, petition) that the Court of Appeals did not question that petitioner occupied the status of a trustee in bankruptcy, with the right of a judgment creditor pursuant to Section 70(c) of the Bankruptcy Act should dispose of the petition. A determination as to the nature and extent of the right of a judgment creditor obviously involves no federal question. In urging his reasons for granting the writ, petitioner mistakes the holding of the Court of Appeals in the instant case. The Court of Appeals did not decide that a different and more beneficial statute would have applied if a judgment creditor with execution returned unsatisfied had instituted the action, nor are there any prior decisions to this effect which he can cite.

Even if the decision of the Court of Appeals in this case were inconsistent with prior decisions, the question decided would still remain a question for the State court and not a federal question.

As Mr. Justice Holmes stated in *Patterson* v. *Colorado*, 205 U. S. 454:

> "* * * There is no constitutional right to have all general propositions of law once adopted remain unchanged. Even if it be true, as the plaintiff in error says, that the Supreme Court of Colorado departed from earlier and well-established precedents to meet the exigencies of this case, whatever might be thought of the justice or wisdom of such a step, the Constitution of the United States is not infringed."

The proposition propounded by petitioner finds no support in any state statutes or the decisions of any state or federal court. The proposition was, in substance, that where a bankruptcy trustee brings a plenary suit in the New York courts on a cause of action of the bankrupt or debtor, no matter how stale or how long outlawed in the hands of the debtor, the cause of action would be revived because, being brought by a bankruptcy trustee it would become *ipso facto* a new and independent cause of action on the same facts in the nature of a creditor's action. None of the cases cited by petitioner under the "strong-arm clause" of the 1910 amendment to the Bankruptcy Act gives any weight to such a proposition.

In re Dalton Electric Company, 7 F. Supp. 465, 468 (D. C. Miss.) cited by petitioner is merely an instance of the application of State law to the determination of the rights of creditors in the State of Mississippi. In that case, the question decided was as to the power of a creditor to sue under Section 4151 of the Mississippi Code of 1930.

If, as he contends, petitioner asserts a creditors's cause of action created by New York statute, he cannot escape the conclusion that the interpretation of the New York statute and the determination of his rights under the statute is solely for the New York courts. While the Court of Appeals in its opinion stated that there may be little in the complaint to support the assumption that the action was brought under the New York statute, it disposed of the case as if the action were an action under Section 60 of the General Corporation Law. In *De Saussure* v. *Gaillard,* 127 U. S. 216, in holding that the Supreme Court of South Carolina was not subject to review in its construction of a State statute, the Court said:

> "It is a state statute conferring certain rights upon suitors choosing to avail themselves of its provisions under certain conditions in certain cases. Who may sue under it, and when, and under what circumstances, are questions for the exclusive determination of the state tribunals, whose judgment thereon is not subject to review by this court." (p. 233)

It is for the State court to construe and apply the Statutes of Limitations enacted by the State Legislature, and its decisions in this respect are not subject to review. (*Harrison* v. *Myer,* 92 U. S. 111; *Wood* v. *Chesborough,* 228 U. S. 672.) Where it appeared that the Supreme Court of Tennessee could have decided a case by sustaining defense of the Statute of Limitations, there was no Federal question necessarily involved. (*Johnson* v. *Risk,* 137 U. S. 300.)

In an action by an assignee in bankruptcy to set aside conveyances as being in fraud of creditors, the validity of the conveyances is not a Federal question. (*McKenna* v. *Simpson,* 129 U. S. 506.)

While it is true that New York courts have several times held that a creditor has no status to bring an action under Section 60 of the General Corporation Law unless he has first obtained a judgment with execution returned unsatisfied, there has never been any holding as to the applicable Statute of Limitations upon a suit by a creditor with such a status when seeking to realize upon choses of action of an insolvent corporation. When the Court of Appeals in this case finally decided this question, it based its decision on substantial State grounds.

> "This Court from the time of its foundation has adhered to the principle that it will not review judgments of state courts that rest on adequate and independent state grounds. *Murdock* v. *Memphis,* 20 Wall. 590, 636; *Berea College* v. *Kentucky,* 211 U. S. 45, 53; *Enterprise Irrigation District* v. *Farmers Mutual Canal Co.,* 243 U. S. 157, 164; *Fox Film Corp.* v. *Muller,* 296 U. S. 207. The reason is so obvious that it has rarely been thought to warrant statement. It is found in the partitioning of power between the state and federal judicial systems and in the limitations of our own jurisdiction." (*Herb* v. *Pitcairn,* U. S. (Nos. 24 & 25 this term decided Feb. 5, 1945).)

There is nothing in this record which is ambiguous or which presents any reasonable grounds to believe that the judgment rests on the decision of a Federal question.

CONCLUSION

The record discloses that no Federal question was presented for decision to the New York Court of Appeals. The decision of the Court of Appeals was concerned solely with the interpretation and application of State statutes. The petition for certiorari should be denied.

Respectfully submitted,

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(GP6581)

(4)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

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REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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1. Respondent repeatedly asserts that the Court of Appeals held in the instant case that even if a judgment creditor had been the plaintiff, the statute of limitations would have barred the action. Thus respondent states (Br., p. 4):

> "The effect of the decision of the Court of Appeals was that, assuming that a trustee in bankruptcy had the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied, as contended by petitioner; and, assuming the suit was brought by such a judgment creditor under the State statute (Section 60, General Corporation Law), as contended by the petitioner; it was nevertheless barred by the State Statute of Limitations."

Again at page 5 of its brief, respondent criticizes petitioner's statement of the questions presented on the ground that

> "The Court of Appeals held explicitly that the action was equally barred whether maintained by a trustee in bankruptcy or a judgment creditor."

The Court of Appeals, however, made no such holding. Nowhere in its opinion did it state that the action would have been equally barred if it had been maintained by a judgment creditor. Respondent's reference to the Court of Appeals opinion in this connection is the following quotation therefrom, made at page 4 of Respondent's brief, immediately preceding respondent's assertion as to the Court's holding:

> "There would, indeed. be serious doubt whether a trustee in bankruptcy would have capacity to sue

> upon a cause of action which did not belong to the debtor other than a cause of action to set aside illegal transfers of property and unlawful preferences. (Citing cases.) We need not attempt to resolve that doubt in this case since we hold that under the law of the State the cause of action here asserted is based upon a wrong to the corporate debtor and accrued when the wrong to the debtor corporation was complete" (R. 86).

This quotation obviously does not state that the action would have been barred if maintained by a judgment creditor, as respondent asserts.

What the Court of Appeals does hold in the instant case is a twofold proposition: (1) that petitioner, although a trustee in bankruptcy, is limited to the rights and status of the debtor corporation because the facts alleged in the complaint constitute a wrong to the debtor corporation; and (2) that *Buttles* v. *Smith*, 281 N. Y. 226 (and the line of cases holding to the same effect) remain the law of New York. The necessary result of these two propositions is to deny to petitioner, as a trustee in bankruptcy, the rights and status which a judgment creditor would have been accorded as plaintiff in the instant action, in violation of the provisions of Section 70c of the Bankruptcy Act.

This is the necessary result because the purported distinction made by the Court, between the judgment creditor cases which were reaffirmed and the instant case, is entirely without substance. In *Buttles* v. *Smith* (*supra*), the facts alleged stated a wrong to the corporation. The action was based upon the transfer of corporate assets to the defendants in payment of personal obligations of the president. "Any action on behalf of the insolvent corporation to recover the funds would have been barred," as respondent admits (Br., p. 9). Nevertheless the judgment creditor was

held not limited to the rights of the corporation. Although the facts alleged constituted a wrong to the corporation, the judgment creditor's action was held to have accrued only after judgment was obtained with execution returned unsatisfied, not at the earlier date when the wrong to the corporation occurred.

The doctrine in *Buttles* v. *Smith* has been long recognized by the New York Courts. In *Shepard Co.* v. *Taylor Publishing Co.*, 234 N. Y. 465 (cited in the *Buttles* case), the Court expressly stated: "The corporation or its stockholders might have brought this action * * *". Yet the Court did not limit the judgment creditor to the rights of the corporation, but held that the statute commenced running only after judgment was obtained with execution returned unsatisfied. Likewise, in *Rosenkranz* v. *Doran*, 264 App. Div. 335, the payment of dividends out of capital created a cause of action enforceable by the corporation, as well as by its judgment creditors, under N. Y. Stock Corp. Law Sec. 58. Following the *Buttles* principle, the Court held that the judgment creditor's action accrued not when the wrong was done to the corporation, but years later when judgment was obtained and execution returned unsatisfied.

Since *Buttles* v. *Smith* is reaffirmed in the instant case, it is still the law of New York that a judgment creditor, even though suing on facts constituting a wrong to the corporation, is not barred by the statute of limitations applicable to the corporation. Hence the Court in the instant case denied petitioner the rights of a judgment creditor under State law, when it limited petitioner to the rights of the corporation on the ground that the facts alleged constituted a wrong to the corporation.

The opinion of the Court of Appeals attempts to formulate this purported distinction between the reaffirmed judgment creditor cases and the instant case as follows (R. 86):

> "The cause of action accrued to the debtor when the wrong occurred and though the statute permits a creditor or stockholder to bring an action for the wrong done to the corporation, the damage or injury to a creditor, like the damage or injury to a stockholder, *arises only indirectly from the damage or injury to the corporation and is repaired when the damage or injury to the corporation is repaired. That, as we have pointed out, was not true of the cause of action asserted in Buttles* v. *Smith* (281 N. Y. 226, *supra*), under a different subdivision of the same section of the statute." (Italics supplied.)

Contrary to the foregoing, both in *Buttles* v. *Smith* and in the instant case, the injury arose indirectly from the damage to the corporation and is repaired when the damage to the corporation is repaired. The injury (to the creditor in one case and the trustee in bankruptcy in the other) resulted indirectly from the reduction of the corporate assets which would have been available to pay the corporate debts; and the restoration of the corporate assets would have repaired the damage both to the corporation and the creditor and trustee in bankruptcy.

If a decision denies to a trustee rights which would have been accorded to a judgment creditor under state law, this Court is not precluded from so holding merely because the state court declares that there is a distinction between the trustee's action and the judgment creditor's action. To hold otherwise would permit the state court to pay lip service to Section 70e of the Bankruptcy Act, while in actuality disregarding its mandate. That, it is respect-

fully submitted, is the effect of the decision of the Court of Appeals in the instant case.

2. The respondent argues (Br., p. 12) that "Even if the decision of the Court of Appeals in this case were inconsistent with prior decisions, the question decided would still remain a question for the State court and not a federal question", quoting from *Patterson* v. *Colorado,* 205 U. S. 454, in support thereof.

This argument is misleading because based upon a misconception of petitioner's position. Of course, the reversal by a state court of prior decisions ordinarily raises no federal question. In *Patterson* v. *Colorado,* quoted by respondent, this Court held that a State court decision generally "is not an infraction of the 14th Amendment merely because it is wrong or because earlier decisions are reversed".

If in the instant case the Court of Appeals had held that hereafter judgment creditors suing on facts stating a wrong to the corporation would be limited to the rights of the corporation as to the statute of limitations, thereby reversing the doctrine of *Buttles* v. *Smith,* that would have presented no federal question. But the Court of Appeals did not reverse, but expressly reaffirmed *Buttles* v. *Smith.* The inconsistency here is between the reaffirmed decisions recognizing rights in judgment creditors and the instant decision denying the same rights to a trustee in bankruptcy in the same situation. That inconsistency does raise a federal question, since it involves a denial to a trustee in bankruptcy of rights vested in him under Section 70c of the Bankruptcy Act.

3. Respondent also argues (Br., pp. 13, 14) that petitioner may not complain as to the state court interpreta-

tion of N. Y. General Corp. Law Sec. 60 or the statute of limitations. Petitioner makes no such complaint, but accepts the state court interpretation of both statutes. All that petitioner asks is that he be accorded, pursuant to Section 70c of the Bankruptcy Act, the rights granted to a judgment creditor under the state court interpretation of those statutes. Petitioner does not question the power of the State to determine the applicable statute of limitations for any class of litigants. But he does question the power of the State, once it has granted certain rights to judgment creditors under the statute of limitations, to deny those rights to a trustee in bankruptcy.

4. Respondent asserts (Br., pp. 5-7) that the order appointing petitioner named him a "Special Trustee" and authorized him to sue only as to causes of action existing in favor of the Debtor. If respondent is here contending that petitioner is not a bankruptcy trustee, the clear answer is that the Court of Appeals rejected this same argument on a prior appeal in which the capacity of petitioner to sue was challenged (*Hastings* v. *Byllesby & Co.*, 286 N. Y. 468).

If, however, respondent is here arguing that even though petitioner was a trustee in bankruptcy, he did not become vested with the rights of a judgment creditor pursuant to Section 70c because he was authorized to sue only as to causes of action belonging to the Debtor, the answer is that as to these assets of the Debtor, the petitioner was vested with the same rights as any ordinary bankruptcy trustee. Petitioner was appointed "Special Trustee" because he did not obtain title to *all* corporate property; but as to that property which was vested in him (the prosecution of the specified actions), he became a bankruptcy trustee with full

title and status under Section 44 of the Bankruptcy Act, including the rights of a judgment creditor under Section 70c thereof.

5. Both the Court of Appeals (R. 85, 86) and respondent assert that petitioner's suit was brought solely on behalf of the corporation, to the exclusion of the rights of creditors. But, as just shown, the petitioner was vested with all of the rights of a trustee in bankruptcy as to the causes of action in question, including the rights of a judgment creditor pursuant to Section 70c. Nor did anything in the complaint state that petitioner sued solely on behalf of the corporation. On the contrary, the complaint expressly affirms petitioner's capacity as bankruptcy trustee and therefore, by necessary implication, his rights and status under the Bankruptcy Act, including those of a judgment creditor derived from Section 70c thereof.

6. Respondent asserts (Br., p. 11) that a cause of action accruing solely to the creditors of a corporation and not belonging to the corporation itself does not pass to a trustee in bankruptcy. Whether that is correct or not, it is not applicable in the instant case because the cause of action alleged by the petitioner is not vested exclusively in the creditors of the debtor. General Corp. Law Sections 60(1) (2) and 61 (quoted in Appendix to Petition), under which the action is brought, authorize suit by both the corporation and its creditors to compel payment by directors and officers of assets acquired by them or lost through violation of their duties. It is elementary that a cause of action which is vested in the corporation, as well as in its creditors, passes to the trustee in bankruptcy of the corporation, who may enforce it for the benefit of both the corporation and its creditors (*Gochenour* v. *Cleveland Terminals Bldg.*

Co., 118 F. (2d) 89 (C. C. A. 6); *Stephan* v. *Merchants Collateral Corp.*, 256 N. Y. 418; *Cowin* v. *Jonas*, 293 N. Y. 838).

The mistake which respondent and the Court of Appeals make is to reason that *because* the action must be vested in the corporate debtor in order to pass to the trustee in bankruptcy, therefore the trustee enforcing such action is limited to the rights and status of the debtor. That is a *non sequitur* which would nullify the provisions of Section 70e of the Bankruptcy Act, vesting in a trustee not only the title of the bankrupt, but also "all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists."

7. Respondent argues (pp. 7, 8) that the instant action is not brought under General Corp. Law Section 60 because the complaint made no reference to such statute. No such reference was required. The decision of the Court below was rendered on the basis that this was an action maintained under General Corp. Law Section 60 (R. 86). The law is well settled that a statutory cause of action is encompassed in a complaint which alleges the facts required to invoke the statute, notwithstanding that the statute itself is not mentioned (*Reynolds Investing Co., Inc.* v. *Reynolds*, N. Y. Law Journal, November 22, 1938, McLaughlin, J., aff'd 256 App. Div. 912, mdfd. on another point, 281 N. Y. 180; *P. G. Poultry Farm* v. *Newtown B.-P. Mfg. Co.*, 248 N. Y. 293, 297).

Following the same line, respondent asserts (Br., pp. 7-9) that petitioner's contention that the instant action was brought under General Corp. Law Section 60 was an afterthought. This statement is incorrect and is unsupported by any reference to the record.

Conclusion.

Under the decision of the Court below, trustees in bankruptcy suing on the basis of state statutes conferring rights on both a corporation and its creditors would be limited to the status of the bankrupt corporation, even though a judgment creditor so suing would have enjoyed superior rights with respect to the statute of limitations. This is contrary to Section 70c of the Bankruptcy Act and the applicable decisions of the Courts. It involves a Federal question of substantial importance which calls for an authoritative ruling by this Court. The Petition for a writ of certiorari should be granted.

Dated: March 20, 1945.

Respectfully submitted,

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